

Investor-state dispute settlement reform – Mapping the way forward

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Abstract

The Honourable Teresa Cheng GBS, SC, JP, Secretary for Justice, Hong Kong Special Administrative Region of the People's Republic of China, outlines the major issues pertinent to investor-state dispute settlement (ISDS) reform in Hong Kong and internationally.

Introduction

Recourse to ISDS has been an important feature of modern investment treaties since the 1980s. It allows a foreign investor to bring a claim directly against the sovereign state in which the investment takes place. In recent years however, ISDS has been criticised for lacking legitimacy. Reforms are called for.

As an investment hub and international dispute resolution centre, Hong Kong stays astute to the ongoing debate on possible ISDS reform. Our mind is set on how to properly resolve investor-state disputes in light of the growing number of foreign investments along the Belt and Road routes. The United Nations Commission on International Trade Law (UNCITRAL) Working Group III (WG III) has been entrusted to work on possible ISDS reform at the international level.

On 13 February 2019, the Department of Justice (DoJ) co-organised with the Asian Academy of International Law (AAIL) the ISDS Reform Conference: Mapping the Way Forward, with a view to contributing to

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the ISDS reform discussion and facilitating relevant policy-making in the Asia-Pacific region. The event attracted over 200 participants, consisting of leading international practitioners, academics, business leaders and senior officials from international organisations such as the International Centre for Settlement of Investment Disputes (ICSID) and UNCITRAL, as well as senior government officials including those from the Ministry of Foreign Affairs and Ministry of Commerce of the People's Republic of China. This short article seeks to outline the major issues pertinent to ISDS reform, with reference to the insights shared by the speakers at the conference.

A word of caution

Before going into the details of ISDS reform, a word of caution is in order. First, while perceptions may be relevant to states in making policy decisions on ISDS and maintaining the legitimacy of ISDS, deliberations on the case for its reform should be fact-based. Second, any ISDS reform measure should not compromise the flexibility of arbitration. The beauty of arbitration is its flexibility. Parties are free to choose a tribunal which will act promptly and be able to devise procedures that will best suit the relevant case at hand. Reforms which come at the expense of flexibility may be worth a second thought.

Consistently wrong or wrongly consistent?

Inconsistency and lack of predictability are some of the concerns identified by the UNCITRAL WG III. Generally, consistency would support the rule of law and enhance confidence in the stability of the investment environment, thereby bringing legitimacy to the regime.

While the importance of the rule of law is beyond doubt, there is, though, the question of whether 'inconsistency' is necessarily undesirable. As in the common law system where judges' dissenting opinions may over time become the prevailing law, inconsistent arbitral decisions do not necessarily reflect a lack of rule of law. As suggested by Professor Brigitte Stern in the conference, contradictions may be seen as dialectical in the sense that they foster 'cross-fertilisation' of different positions. Inconsistencies will eventually be resolved in favour of the best approach.

The arbitral process of converging by emerging consensus fits well with the evolutionary character of international investment law.

Even if inconsistency is seen as a problem, would a standalone appellate mechanism, tasked with a substantive review of arbitral decisions, be practical and desirable?

‘Appeal is a balancing act between finality and correctness,’ as put eloquently by Professor Albert Jan van den Berg in the conference. However, considerable political will may be needed to negotiate a new treaty for a novel institutional appeal structure. There are also technical issues yet to be resolved, such as how the appeal mechanism for ISDS awards would interact with the existing multilateral instruments such as the New York Convention and the ICSID Convention. Professor Jan van den Berg finds it doable to amend the ICSID Convention by certain inter se agreements to provide for an appellate body thereunder.

Safeguards may also be put in place to uphold the delicate balance. For the appeal procedure and grounds of appeal, reference may be drawn to Section 69 of the English Arbitration Act 1996 and opt-in appeal provisions under Schedule 2 to the Hong Kong Arbitration Ordinance (Cap 609), whereby leave has to be obtained from the court, and appeal is limited to points of law. Further thoughts may, however, be warranted on whether domestic courts are the right avenue for challenging ISDS awards, given the international nature of these disputes and the wide implications that usually entail.

Arbitrators and decision-makers

It has also been suggested that ISDS is marked by a ‘revolving door’, in that single individual actors may play multiple roles as arbitrators, counsel, expert witnesses and tribunal secretaries within the ad hoc arbitration system. Such ‘double hatting’ poses a threat of conflicts of interest. An effective challenge mechanism is seen to be a critical safeguard to ensure arbitrators’ independence and impartiality. This challenge system is, however, subject to abuse, for there is a general increase in the number of tactical, vexatious or frivolous challenges.

Some reformers therefore suggest replacing the ad hoc tribunal system with a court system. The court will consist of judges appointed or elected by states on a permanent basis or for a fixed term. It is hoped that, by sitting permanently and deciding cases over time, judges would deliver consistent decisions. Certain recent investment treaties (such as the Comprehensive Economic and Trade Agreement between Canada and the European Union) have indeed envisaged the creation of such a permanent, international court institution. Strong political will is again indispensable for the creation of such an institution. Its development is being closely observed by businesses and professionals, as well as states.

Costs and duration

WG III acknowledged that lengthy and costly ISDS proceedings may raise practical challenges to claimant investors and respondent states. Third-party funding thus becomes a heated topic, with concerns raised on conflicts of interest and extent of disclosure, as well as on transparency of third-party funding arrangements.

Following the Hong Kong decision in *Unruh v Seeberger & Anor* [2007] 2 HKC 609, where it was left open whether maintenance and champerty would apply to arbitrations in Hong Kong, and subsequent to the Law Reform Commission's report in 2016, legislative amendments to the Hong Kong Arbitration Ordinance passed in 2017 (which came into effect in February 2019) now makes it beyond doubt that third-party funding of arbitration is allowed. The Code of Practice for Third-Party Funding of Arbitration, issued in December 2018, further plays a useful role in setting minimum standards of good practice for third-party funders of arbitration and laying down safeguards for funded parties.

As for costs, they can be reduced if ISDS proceedings are streamlined. To that end, one should not lose sight of other alternative dispute resolution (ADR) mechanisms for resolving disputes, a prime example being investment mediation.

Investment mediation

Investment mediation is within the mandate of WG III, which is to

consider the possible reform of ISDS and is not limited to investment arbitration. At its core, it is a kind of dispute resolution mechanism that emphasises harmony and achieving a win-win situation for the disputing parties. It provides host states and foreign investors with options to resolve investment disputes consensually with a high degree of autonomy and flexibility. Apart from allowing the disputing parties to control the mediation process, investment mediation can facilitate them to reach mutually beneficial, creative and forward-looking settlement arrangements that are based on their common interests and needs, with the assistance of professional mediators.

As an example, remedies available under investment arbitration are generally limited to monetary damages (with interest) and restitution of property. However it has been observed that, for many ISDS cases, an award of monetary damages or even an injunction is not the optimal solution. As commented by Professor JW Salacuse in a paper in 2009, whilst an arbitration award is a ‘one-dimension solution’ to a problem, a mediated solution is often ‘multi-dimensional’. The range of settlement terms that can be included in mediated settlement arrangements is limitless.

Professor Lucy Reed shared the view at the conference that investment mediation is a promising ADR mechanism in ISDS. She has provided some thoughts on promoting investment mediation. These include emphasising the range of remedies available under investment mediation, publishing successful examples of investor-state mediations with sensitive information redacted, and building mediation procedures into dispute resolution stages, even when the dispute is in arbitration.

On the architecture of procedures, Professor Jack Coe proposed at the conference a ‘concurrent’ or ‘shadow’ mediation so as to promote unencumbered exploitation of the strengths of arbitration and mediation while also containing costs and preventing one process from disrupting or subjugating the other. Under his proposal, one or more third-party neutrals will pursue collaborative problem-solving efforts that coincide, on a coordinated basis, with mediation. Such an idea of ‘shadow’ mediation is appealing. It is comparable to maritime arbitration, where there is an umpire who will not have to write the award unless the two

arbitrators do not agree with each other. It is worth looking into how this idea can be developed and institutionalised by, for example, crystallising the same into a protocol.

Capacity building and training for government officials are also beneficial for enhancing their understanding on the investment mediation process. The DoJ, ICSID and AAIL co-organised the ‘Investment Law & Investor-State Mediator Training’ in October 2018. This is the first investment law-cum-investment mediation training course in Asia, and is pivotal in developing Hong Kong as an international investment law and dispute resolution skills training centre. Equally important is that, through public education, confidence in the use of investment mediation can be built up, especially amongst government officials representing states.

Investment mediation under the CEPA Investment Agreement

Hong Kong has been a staunch supporter of investment mediation. In the Investment Agreement under the Mainland and Hong Kong Closer Economic Partnership Arrangement (CEPA), we have established mediation as the dispute settlement mechanism. CEPA Investment Mediation Rules (Rules) are now in place, and it is hoped that the Rules may serve as a model for possible ISDS reform.

The mediation mechanism together with the Rules set out, among other things, the factors outlined below.

- **Number of mediators:** the default position is a mediation commission consisting of three mediators (with each party appointing one and the chairperson to be appointed jointly by the parties). The advantage of such an arrangement is that the parties can have a say in appointing its own mediator, which gives them a greater sense of control over the process.
- **Qualification of mediators:** the mediators shall have attained relevant qualifications in mediation, and shall have professional knowledge and experience in the fields of cross-border or international trade and investment and law, and shall remain impartial in resolving the investment disputes.

- **Code of conduct of mediators:** each mediator shall be independent and impartial and shall mediate the dispute in a manner that is transparent, objective, equitable, fair and reasonable. Mediators are required to avoid their performance being affected by their own financial, business, professional, family or social relationships or responsibilities. Unless otherwise agreed by the disputing parties, by accepting an appointment as a mediator, the mediator is deemed to agree not to act in any other role in respect of any differences or disputes which are the subject of the mediation, or in which a party is involved as a disputant pending resolution. Moreover, if during the course of mediation, mediators become aware of any facts or circumstances that may call into question their independence or impartiality in the eyes of the parties, they are required under the Rules to disclose those facts or circumstances to the parties in writing without delay.

Conclusion

The outline above shows that the challenges of ISDS reform for policy makers are enormous but surmountable with proper fact-based studies and professional advice. At this crossroad in our journey to ISDS reform, it is our sincere hope that the conference, together with the efforts made and experience shared by the HKSAR Government and eminent speakers, will assist in mapping the way forward.